UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re BARRE BARNES, Debtors.	Case No. 91-52819 Chapter 7
In re FRAMING SYSTEMS, INC., Debtors.	Case No. 90-52545 Chapter 7 **MEMORANDUM DECISION RE TRUSTEE'S MOTION FOR SUBSTANTIVE AND PROCEDURAL CONSOLIDATION OF CASES**

FACTS

These issues arise before this Court upon the Trustee's Motion for Substantive and Procedural Consolidation of these two cases. The Debtors, Barre Barnes and Framing Systems, Inc. ("Framing Systems"), are affiliated entities in that Mr. Barnes is the sole shareholder of Framing Systems. The Trustee has asserted that the business and financial affairs of the Debtors are so commingled and interwoven and that their records are so incomplete and inaccurate that substantive and procedural consolidation of these cases would promote the equitable and economic administration of both estates.

DISCUSSION

A. Substantive Consolidation

Substantive consolidation involves the pooling of the assets and liabilities of two or more related entities into a unitary debtor estate. The liabilities of these entities are then satisfied from the common pool of assets created by consolidation. Eastgroup Properties v. Southern Motel Ass'n, Ltd., 935 F.2d 245, 248 (11th Cir. 1991). Substantive consolidation effectively merges two or more estates. In re Parkway Calabasas Ltd., 89 Bankr 832, 839 (Bankr. C.D. Cal. 1988). The purpose of substantive consolidation is to ensure the equitable treatment of all creditors. Id. It affects the substantive rights of creditors. In re Lewellyn, 26 Bankr. 246, 251 (Bankr. S.D. Iowa 1982). Therefore, it should be used sparingly. Eastgroup Properties, 935 F.2d at 248.

The Court has a duty to scrutinize the evidence carefully before consolidation, even if there is no opposition to consolidation. In re Lewellyn, 26 Bankr. at 251. While not specifically authorized by the Bankruptcy Code, bankruptcy courts have the power to substantively consolidate cases by virtue of their general equitable powers under Section 105. Eastgroup Properties, 935 F.2d at 248 (and cases cited therein). The Court must conduct an inquiry to ensure that consolidation yields benefits offsetting the potential prejudice and harm it inflicts on objecting parties, and the proponent must show that (1) there is substantial identity between the entities to be consolidated; and (2) consolidation is necessary to avoid some harm or to realize some benefit. Id.

Among the factors that are relevant to the Court's analysis are:

(1) The presence or absence of consolidated financial statements.

(2) The unity of interests and ownership between various corporate entities.

(3) The existence of parent and intercorporate guarantees on loans.

(4) The degree of difficulty in segregating and ascertaining individual assets.

(5) The existence of transfers of assets without formal observance of corporate formalities.

(6) The commingling of assets and business functions.

(7) The profitability of consolidation at a single physical location.

(8) The parent owning the majority of the subsidiary's stock.

(9) The entities having common officers or directors.

(10) The subsidiary being grossly undercapitalized.

(11) The subsidiary transacting business solely with the parent.

(12) Both entities disregarding the legal requirements of the subsidiary as a separate organization.

Id. at 249-50. No single factor is likely to be determinative in the court's inquiry. Id. at 250.

Upon a review of the foregoing factors, the proponent must show that, on balance, consolidation will foster a net benefit among all unsecured creditors that outweighs any potential harm to interested parties. In re Hemingway Transport, Inc., 954 F.2d 1, 12 (1st Cir. 1992). Consolidation is appropriate if the debtors' assets and liabilities are so intertwined that it would be impossible, or financially prohibitive, to disentangle their affairs and to administer them as separate entities. Id. at 11. Also, it is appropriate if the interrelationships of the debtors are hopelessly obscured and the time and expense necessary to unscramble them is so substantial as to threaten the realization of any net assets for all of the creditors. In re Evans Temple Church of God in Christ, 55 Bankr. 976, 981 (Bankr. N.D. Ohio 1986). Once the proponent has established a prima facie case, the Court may order substantive consolidation unless an objecting creditor shows that it relied solely on the credit of one debtor and is certain to suffer more than minimal harm as a result of consolidation. Eastgroup Properies, 935 F.2d at 249.

The Trustee in these cases has argued that the business and financial affairs of both Debtors are so commingled and interwoven that it is impossible or prohibitively expensive to separate the assets and liabilities of each. One Debtor is the sole shareholder of the other. Moreover, the Debtors have failed to observe corporate formalities with respect to inter-entity transfers and payment of obligations, and the records of both are inadequate. See In re Luth, 28 Bankr. 564, 567 (Bankr. D. Idaho 1983)(consolidation appropriate). The Trustee has also represented that none of the creditors of these estates would be severely prejudiced by the substantive consolidation of these cases. There is no opposition to this Motion. It appears from a review of the factors enumerated in Eastgroup Properties that adequate cause exists and, on balance, it is appropriate to order that these cases be substantively consolidated.

B. Joint Administration

Bankruptcy Rule 1015(b)(4) provides in relevant part, "If...two or more petitions are pending in the same court by or against a debtor and an affiliate, the court may order a joint administration of the estates. Prior to entering an order, the court shall give consideration to protecting creditors of different estates against potential conflicts of interest..." Fed. R. Bankr. P. 1015(b)(4).

The Advisory Committee Note to the Bankruptcy Rule 1015 provides that "[j]oint administration as distinguished from consolidation may include combining the estates by using a single docket for the matters occurring in the administration, including the listing of filed claims, the combining of notices to creditors of the different estates, and the joint handling of other purely administrative matters that may aid in expediting the cases and rendering the process less costly. Fed. R. Bankr. P. 1015 advisory committee note (1983).

Joint administration is a creature of procedural convenience to avoid the wasting of resources and duplication of effort involving related debtors, but the estates of each debtor remain separate, and administrative efficiency may be achieved without altering substantive rights. In re Steury, 94 Bankr. 553, 553-54 (Bankr. N.D. Ind. 1988).

In view that these cases have been substantively consolidated into one proceeding, it would be appropriate that these cases be jointly administered under one case number. The Trustee's Motion is therefore granted as follows:

1) The two cases are consolidated into a single Chapter 7 case.

2) All assets and liabilities of the Debtors are merged, and all inter-entity obligations are eliminated. Any obligation of either Debtor and the guaranty of that obligation by either Debtor are deemed to be one obligation. Any claim filed in either case is deemed to be filed against the Consolidated Debtors in the Consolidated Case.

3) Consolidation shall in no way adversely affect security interests and liens held by any secured creditors of either of the Debtors in or upon any of the assets of either of the Debtors.

4) The caption of all original pleadings filed hereafter in the Consolidated Case shall include the names of both Debtors, both case numbers, and the phrase, "Consolidated Case."

5) After the entry of the Order consolidating these cases, all original pleadings shall be

filed in the case of Barre Barnes, and all original docket entries shall be made in that case. The clerk is also directed to file a copy of the Order consolidating these cases in the file for the case of Framing Systems.